



COMMENT

NUMBER 211 – JANUARY/FEBRUARY 2002

ASSIGNING CPP RETIREMENT BENEFITS

Shifting retirement income from the spouse with the higher marginal tax rate to the spouse with the lower marginal tax rate can reduce the total income tax paid within the family unit. The Canada Pension Plan (CPP) allows spouses and common-law partners to share their retirement pensions. (To simplify the rest of this article, “spouse” is used to refer to a spouse or a common-law partner.) There are, however, specific rules that should be considered in planning such assignments.

While an assignment of the CPP retirement benefit redistributes the flow of a couple’s benefits, it does not increase or decrease the overall pension. If one spouse has never contributed to CPP, then the sharing of only the working spouse’s pension is permitted. Otherwise, if spouses opt for assignment, the pensions of both spouses must be assigned. It is not possible to assign the pension of one spouse — the person with the higher income, for example — and not the other.

To share the CPP pensions, both spouses must be at least 60 years old and both spouses must be receiving CPP retirement benefits (unless only one spouse was a CPP contributor). The maximum amount that can be shared is dependent on how long the contributor and the spouse have lived together, and the number of years in the contributory period.

The portion of the retirement pension earned while living together is split between the two spouses.

Example:

Background:

- Tom and Maggie have been married for 30 years.
- Tom has contributed to CPP for 32 years. For 30 of these 32 years, Tom has been married to Maggie.
- Maggie has contributed to CPP for 15 years, all of which time she has been married to Tom.
- Tom has earned a monthly pension of \$600, while Maggie’s monthly pension is \$280.

Calculations:

- 93.75% of Tom’s \$600 monthly pension can be shared with Maggie, for a total of \$562.50 (93.75% of \$600). This percentage is based on 30 years of contributions while living together divided by 32 years of total contributions [$(30 \div 32) \times 100 = 93.75\%$].
- 100% of Maggie’s \$280 monthly pension can be shared with Tom. This percentage is based on 15 years of contributions while living together divided by 15 years of total contributions [$(15 \div 15) \times 100 = 100\%$].

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- During their years together, Tom and Maggie collectively earned a total pension amount of \$842.50 (\$562.50 + \$280.00 = \$842.50)

Once the assignment application is approved:

- Tom will receive \$37.50, which he earned prior to his relationship with Maggie, plus \$421.25 (50% of \$842.50), for a total pension of \$458.75.
- Mary will receive \$421.25 (50% of \$842.50).

Each spouse includes the actual amount received in income subject to tax. Using the above calculations:

- If Tom and Mary do not assign their pensions, Tom will include \$600 a month in income, while Mary will include \$280.
- If Tom and Mary proceed with the assignment, Tom will include only \$458.75, whereas Mary will include \$421.25.
- The amount of tax payable on that income will depend of each spouse's tax bracket and available tax credits.

Sharing arrangements are permitted only upon approval of a CPP *Application for Assignment of Retirement Pension(s)*, with no allowance for backdating. Pension sharing arrangements will cease in any of the following circumstances: if either spouse or common-law partner asks Human Resources Development Canada to end the assignment; the 12th month after separation; the month of divorce; if a spouse or common-law partner who never contributed to CPP begins contributing; or, the month one of the spouses or common-law partners dies.

The Quebec Pension Plan also allows for the sharing of retirement benefits; however, the conditions of eligibility differ from those of the Canada Pension Plan. It is possible to arrange an assignment of pensions where one spouse or common-law partner receives CPP, and the other receives QPP.

The splitting of the CPP and QPP retirement pensions is an effective and easy-to-implement strategy for reducing the overall income tax bill within a family unit.

I/R 3201.01

INSURANCE TRUSTS

A unique feature of a life insurance plan is the ability to direct that the payment of the proceeds be made to a named beneficiary. This action of naming a beneficiary provides many benefits for the policyholder. Creditor protection of the cash values can be achieved if the named beneficiary is within the prescribed class of related beneficiaries. With a named beneficiary, the funds from the life insurance benefit do not pass through the insured's estate, and therefore are not exposed to the creditors of the estate, are not subject to probate fees, and are not open to public scrutiny.

There are, however, circumstances under which it would not be appropriate to name a certain individual as the beneficiary of the insurance policy. For example,

age or capacity of the intended beneficiary may be an issue, or the beneficiary may not be the intended capital beneficiary.

Consider the situation where a wife and husband name each other as beneficiaries of their respective insurance policies, but also want to plan for the flow of the policy proceeds in the event of a common disaster. In such a case, the couple wants to ensure that the funds flow to the benefit of their minor children to provide important financial protection. While the funds could pass through the estate, the couple is worried about potential creditors or estate litigants, exposure to probate fees, and the loss of privacy associated with probated wills, which are public documents.

The couple could name the children as contingent beneficiaries. However, the insurance benefit cannot be paid directly to a minor. Where minor children are directly named as beneficiaries, the insurance company is compelled to pay the life insurance proceeds into court, which in turn will give the money to the public trustee to administer on behalf of the minor(s). This means that the investments from the insurance proceeds will be based on the provincial public trustee act, and the money will be turned over to the minor(s) upon attaining the age of majority. This may be a much younger age than the parents would have wanted.

The situation outlined above could be better handled with the use of an insurance trust. A trust could be set up today to own insurance policies on the life of each parent. Alternatively, the trust could hold a policy on both lives, with proceeds payable on the second death. The wife and husband could settle money, sufficient to pay the life insurance premiums, on the trust annually. Upon the premature death of either spouse, or on the second death if applicable, the life insurance benefit would be paid to the trust. The trustee would be empowered to hold and invest the money based on the instructions within the trust document. The trust document would also set out the distribution plan for the annual income, along with directions as to who would have access to the capital. Use of this type of arrangement would shelter the

cash value from the creditors of the wife and husband, avoid probate fees, keep the money private, allow broader investment powers, and restrict access to income and/or capital.

The trust described above would be an inter vivos trust, and as such it would be taxed at the top personal income tax rate with no benefit of marginal tax rates. To avoid this problem, an insurance trust could be created by way of beneficiary designation provided in a will; it would then qualify as a testamentary trust that is taxed on the marginal tax rate system, the same as individuals. The will could set up the XYZ trust, naming the appropriate trustees. The insurance policy could then name the trustees for the XYZ trust as beneficiaries of the insurance proceeds. In this fashion, a trust is created by the will to receive the life insurance proceeds. Even though this trust is established by wording in the will, the proceeds do not form part of the estate, and most of the same benefits will be available as apply to any beneficiary designation. Therefore, the proceeds will not be subject to probate fees or to creditors of the deceased. If the will is probated, however, the terms of the trust will be contained in a public document.

Planning involves reviewing objectives and looking for those strategies that will accomplish the stated objective with the fewest number of contentious issues.

I/R 8001.04

REGISTERED RETIREMENT SAVINGS PLANS

Sometimes even the simplest things should be reviewed in order to ensure that all of the features and benefits are used to their best advantages. The Registered Retirement Savings Plan (“RRSP”) is one such program. A review of the basics may create a blinding flash of an obvious planning opportunity, especially as circumstances change over time.

Although the Canada Customs and Revenue Agency (“CCRA”) notifies every taxpayer of his or her RRSP deduction room on the current notice of assessment, understanding how the amount is calculated can aid in long-term planning. An individual’s ***unused RRSP deduction limit*** is calculated as follows:

Add: Unused RRSP deduction limit from the preceding year

Add: The lesser of:

- 18% of “earned income” from the preceding year, and
- \$13,500, minus the individual’s pension adjustment for the preceding year

Add: The individual’s pension adjustment reversal (“PAR”) for the year

Deduct: RRSP contributions already made for the current year

Deduct: The individual’s net past service pension adjustment (“PSPA”) for the year

The above calculation determines an individual’s maximum contribution remaining for the current year. This contribution can be made to an RRSP in the individual’s name, or to a spousal RRSP. Spousal RRSP contributions can be made in respect of a spouse or a common-law partner.

It is important to note that the contributing individual is not compelled to deduct the RRSP contribution immediately. Rather, the ability to claim a deduction for the contribution may be carried forward. Carrying forward and deducting a current contribution in a future year would be appropriate when an individual will be in a higher tax bracket in the future (for example, because future income will be higher, or because current income is lower than normal for any number of reasons). The strategy of matching deductions

with higher income amounts will maximize the value of the deduction on the individual’s tax return.

Earned income is calculated as follows:

Add: Employment income less union/professional dues

Add: Net income for sole proprietors or partners

Add: Net rental income from real estate

Add: Taxable family support payments received

Add: Net research grants and royalties

Add: Disability payments from CPP or QPP (but not private plans)

Deduct: Net rental losses from real estate

Deduct: Deductible family support payments paid

It should be noted that certain items reduce an individual’s earned income and therefore RRSP contribution room. For example, rental losses and deductible family support payments are often overlooked reductions.

Children start creating RRSP deduction room at any age, as long as they report earned income on an income tax return. It makes sense to accumulate RRSP deduction room starting at a young age, but to make corresponding contributions much later, when long-term savings are possible and the deduction has greater value.

I/R 5401.06

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This commentary is published by the Canadian Association of Insurance and Financial Advisors (CAIFA) in consultation with an editorial board comprised of recognized authorities in the fields of law, life insurance and estate administration.

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Published by: Canadian Association of Insurance and Financial Advisors
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ISSN 0382-7038

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